

“Please, Please, Me....” *Bangladesh and Vietnam*

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By Larry Speidell

A fifteen minute walk takes you from the cool luxury of the Westin Hotel, in Gulshan 2, Dhaka, to the mud bank of Banani Lake where a ferry brings you to a different sort of world.

This is a slum of corrugated metal huts, sharing common walls, where the narrow dirt paths aren't even shown on the Banani neighborhood map. It is a world of poor, but proud people.

And it's a world where children are everywhere. Some have even learned a few words of English in the improving schools of Bangladesh. If you produce a Polaroid camera, give out a few pictures, you become a member of the community. Smiles are all around. “Please, please, me...” the kids say tugging at my sleeve for a photograph. It's not long before the film has run out, and I shuffle off, lost in a maze of alleys.

This trip in Asia focused on company research in two very different frontier countries, Bangladesh and Vietnam. The former is following India's successful growth model with its somewhat chaotic democracy accompanied by an Anglo-Saxon tradition of laws. Vietnam, on the other hand, is often talked of as the “next” China, and while it lacks the scale of its northern neighbor, it shares the tradition of a Communist history that is adapting pragmatically to the opportunities of globalization.

We visited Bangladesh and Vietnam last in 2008, and since then they have survived the global financial crisis. Both countries have now returned to roughly 6% growth rates in Real GDP. Inflation has come down to around 8% in both places, whereas two years ago, it was running at 11% in Bangladesh and above 25% in Vietnam.



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	Bangladesh	Vietnam	Malaysia	Singapore	Japan	USA
RGDP Growth 2010e	6%	6%	5%	8%	0%	2%
GDP per capita, PPP (current intl \$)	\$1,334	\$2,785	\$14,215	\$49,284	\$34,099	\$46,716
Inflation	8%	8%	3%	4%	0%	2%
Population (mil)	160.0	86.2	27.0	4.8	127.7	304.1
% Rural	73.3%	72.6%	31%	0%	34%	19%
% Literate	50%	90%	80%	90%	100%	100%
Electricity (kWh/capita)	136	573	3,262	8,507	8,233	13,648
Corruption (10=best)	2.0	2.6	5.1	9.3	7.5	7.2
Market Cap (\$ Bil)	\$6.7	\$9.6	\$187.1	\$180.0	\$3,220.5	\$11,738
PE	15.0	14.8	16.8	14.9	26.5	15.4
PB	2.0	3.1	2.1	1.7	1.1	1.9
ROE	13%	21%	12%	11%	4%	13%

Source: World Bank, S&P, MSCI, Transparency Int'l, (WDI1002), 2010

In the table above, we have included the U.S. for comparison, along with Japan, Malaysia and Singapore, which we visited on this trip for presentations to the local CFA Societies. Key differences in the table are that the two frontier countries are achieving much higher GDP growth rates and have considerable room to catch up with the developed world given their low levels of GDP per capita. Although PE multiples are roughly similar (except for Japan) we believe that higher growth rates in the frontier give them an edge.

Economics and Stocks

"The first rule of baseball is to get a good ball to hit." – Roger Hornsby (1896-1963), batting average .358

In a recent study, Dimson (2007), found that a country's GDP growth rate tends to have a negative correlation with stock market returns. In other words, high growth countries may have stock markets that under-perform. This probably doesn't mean that we should seek to invest in countries that are economic failures. Rather it means that we may need to avoid the "glamorous" countries for the same reason that so-called "glamour stocks" may under-perform: expectations are simply too high. This was clearly the case for Vietnam in October 2007 when it was priced at 104x trailing earnings according to the S&P Emerging Markets Database. In 2004, I co-authored a paper studying economic growth versus stock returns which focused on a related problem of dilution. We found that many stock markets, especially those with high initial state ownership (such as China) can have a large overhang of initial public offerings (IPOs) that penalize investors in existing stocks. A viable investment strategy in such countries has been for investors to get in line for each new offering, "flip it"... and then get in line for the next one. An effect found across countries, even in the absence of state ownership, was that strong market returns in one year generate high subsequent dilution from IPOs and secondary offerings in the following year. This can cause a reversal in market returns.

Dimson concluded that "even if GDP growth cannot guide equity investors about when to buy stocks, equity price rises are a favorable signal of a developing nation's future economic prosperity." His key point here is that stocks are a leading indicator. We believe this makes it very important to be forward looking and somewhat contrarian with respect to countries. We try to favor those countries where our hopes for future growth are not yet generally recognized by most investors. Also, it is important to keep a weather eye on valuations. One of the valuation metrics we especially like is the comparison of the PE ratios of our stocks with their expected 3-5 year growth rates. We feel good if we can find "PEG" ratios below 0.5, for example, a growth rate above 20% for a stock selling at a PE below 10x. In our investments in the global frontier markets, we don't need to swing at every pitch. And we don't need to invest in every country just because it has a good growth story.



Vietnam

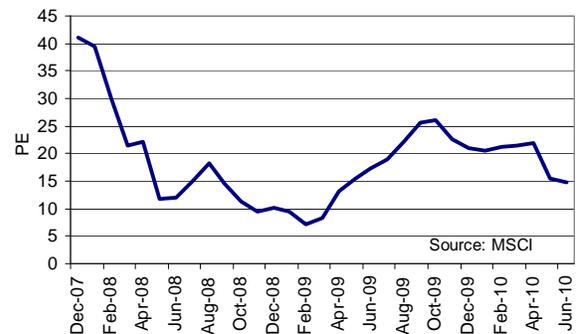
As the price chart to the right shows, Vietnam has been a wild ride for investors, reflecting both the aggressive, competitive nature of the people and the mercurial passions of foreign investors.

When we last visited Vietnam in mid-2008, the market was down more than 50% from its December 2007 high. It was hard to tell whether the carnage would end when the market reached zero or somewhere above that.... Than in early 2009, the government stepped in with a massive stimulus program that included loans at 4%, well below the inflation rate. It was “off to the races” as they say. The market PE history in the lower chart at the right shows that the PE has been a roller coaster. Some of this volatility has been driven by individuals (and even bank officers) who misused the government stimulus by borrowing money under a false pretext and plowing it into the stock market rather than putting it into the real economy.

Today the mood has become more restrained. Interest rates are around 12% versus inflation at 8%, and retail investors on margin are under pressure. The Central Bank has stepped on the brakes. In another move, the government will implement a price control program on October 1st that will add to uncertainty in the corporate sector. Meanwhile, PE multiples have come down to 15x trailing earnings, but there is risk from a potential overhang of IPOs.

With 40% of GDP still under state control, one friend said that the government is inclined to use the stock market like an ATM machine, pushing out an IPO when the authorities need cash. It also was disturbing to hear from an experienced observer who works closely with the government that favoritism of state conglomerates seems to have increased in the past couple of years.

Fundamentally, we like Vietnam. The population of 86 million is hard working and 90% literate. Urbanization is 30%, rising 1% a year. Lots of foreign investment is coming in, and the streets of Saigon have noticeably improved since our last visit.



Highland Coffee Shop: great service, great coffee

Unfortunately, perhaps Vietnam is just too easy to like. If so, the market may be persistently too expensive to deliver good returns except for those investors who are very quick on their feet. One broker told us: "People don't care about PE/PB/EBITDA etc. You have to play the momentum here. [It's a] market that implodes from completely overvalued/overbought/overtraded to the exact opposite."



Bangladesh

Bangladesh, once called East Pakistan and before that part of India, mostly surrounded by eastern India except for a small stretch bordering Burma (Myanmar) in the east. Bangladesh is low lying and thus at the mercy of water and weather. Also to some extent, it is at the mercy of India's sporadic and erratic decisions to open dams upstream and flood parts of the country.



Boys will be boys, Banani Village, Dhaka

Despite and perhaps because of their challenging environment, Bengalis are fiercely proud and quite creative. They have developed fast growing rice to cope with floods and wind resistant rice to cope with cyclones. However, one thing they haven't seemed to develop is traffic lights. As in Mumbai, the traffic jams in Dhaka are monumental. A mélange of battered busses, cars, "tuk-tuk" motor taxis and pedal rickshaws forms a solid mass on streets giving new meaning to the term "grid-lock". And this is accompanied by a constant cacophony of horns that may not move the traffic but at least releases frustrations. Since our last visit, the two years of military government has given way to a civilian regime that, sadly, is back to some of its old tricks. The clamp-down on corruption has been moderated. Bata Shoe for example, reports that shoe smuggling has increased and that some competitors are under-invoicing imports. Meanwhile small shoe makers are getting away with underpaying workers and often avoiding taxes altogether. This is not to say that corruption is more of a problem that in, say Philippines, Russia, Kazakhstan and Kenya, which share similar corruption rankings by Transparency International, http://www.transparency.org/policy_research/surveys_indices/cpi/2009. In the Heritage Foundation ranks of Economic Freedom, <http://heritage.org/index/>, Bangladesh rates a score of 51.1, better than China (51.0), Russia (50.3) and Vietnam (49.8).



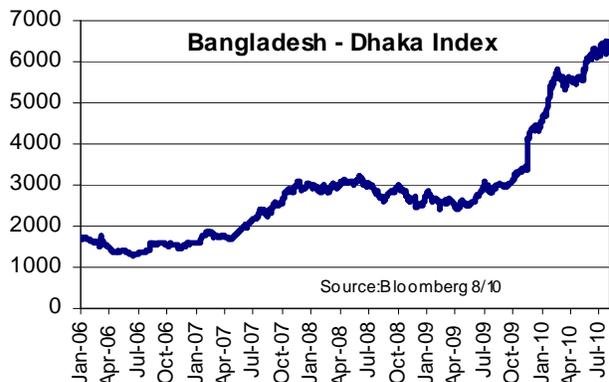
School Uniform, Banani Village, Dhaka

Garment manufacture is a big industry in Bangladesh, employing more than 3 million people. They have been subject to a minimum wage of 1662.5 taka per month (roughly \$24), but after violent protests in June, the government has raised the minimum wage to 3,000 taka, (\$43). We believe this is still low enough to maintain Bangladesh's competitiveness in the garment business worldwide. Meanwhile, education continues to improve life in Bangladesh. I met Shayah Ghosh, Director General of Primary Education, on my flight in, and he invited me to his large office, cluttered with papers and packed with statistics. For its population of 150 million, Bangladesh has 81,508 primary schools, most of them completely free of charge. There are 16.5 million students and 361,000 teachers (43% female) for a student teacher ratio of 46. Sadly, of 4.3 million first graders, half have dropped out by grade five. Another half will drop out before finishing the secondary level. The good news is that there are 640,000 students in university, an impressive figure, even if it is dwarfed by the size of the population. Literacy is now up to 64% for 15 to 19 year olds compared with 50% overall.

The Financial VP of one company, a very devout Muslim, said “the poor people are happy with their fate.” That may be his philosophy, but fortunately, it is not that of the Department of Education.

We revisited the Bashundra (World) Mall, which opened in 2006, and learned that since 2008 three additional malls have opened in the country. A fifth mall, three times the size of these is now under construction. Interestingly, sales at these glitzy malls have been ok but under budget, because it is hard for them to compete with the multitude of small vendors operating out of shacks or street stalls. One consumer related company, ACI, has taken losses and closed stores in its retail venture that was designed to mimic 7-Eleven’s convenience store concept. In the face of consumer resistance to relatively high prices, it has cut back from 70 to 37 of its 2,000 square foot outlets and replaced the management team.

We are a bit less enthusiastic about the stock market in Bangladesh these days for a peculiar reason. “Black money” is a term in Bangladesh for illegally gotten gains. In Bangla, the word is “bokhsis” - a tip or gift. Recognizing that there is a lot of this stuff around, the government implemented a grace period during which the perpetrators could pay a 10% tax on their black money so long as the remainder found its way into the stock market or real estate construction. This would then turn black money into “white money.” In the past year, we suspect that such flows accounted for a significant portion of the stock market’s gains.



Now, that policy has been changed. Hence forth, black money must be invested in infrastructure or power projects to qualify. This change is probably a good thing for the economy since the lights go out regularly in Dhaka, and the national power shortage is estimated at 2,000 megawatts. At the same time that this source of local buying power in the stock market may diminish, the government has imposed a new 10% capital gains tax on institutions, including foreigners. All of this does not mean that Bangladesh is unattractive. We just have to be a bit stingy when it comes to price.

Conclusion

Travelling from country to country every two days does not make for an easy ten day trip, but it is certainly efficient. Japan was probably the most challenging country to visit because it is not very user-friendly for visitors who do not speak Japanese. On the other hand, the courtesy of the people is overwhelming, and the Imperial Hotel’s toilet is a mechanical marvel. Japan’s past twenty years of zero economic growth may serve as a warning to other developed countries these days. One interesting change is many Japanese are now focusing more on the quality of their lives than on their work ethic.



Young Saigon

After traveling to Vietnam and Bangladesh, we arrived in Malaysia, which may be an example of what many frontier countries could look like in a decade or two. Kuala Lumpur has a spectacular city center highlighted by the lofty Petronas Towers, 1482.6 feet tall. On the other hand, Malaysia still has structural and political inconsistencies that are reflected in the vast sums spent on inefficiently producing local Proton cars of their own design. Proton's Malaysian market share has dropped from 60% to 26% since 2002.

Singapore was immaculate as ever and filled with tourists shopping and enjoying the spectacular hotels and malls. Singapore is perhaps a bit boring, but it is a beautiful city-state. Incidentally, Singapore ranks second to Hong Kong in the Heritage Foundation ranking of Economic Freedom. Its score is 86.1, versus the United States in eighth place with a score of 78.0.

Overall, this trip reconfirmed many of the attractions of Bangladesh and Vietnam to us. Like the kids in Banini, saying, "please, please...me", these are countries that are often neglected but that deserve more attention by investors. Both are scrappy countries that both delight and assault the visitor with new sights, sounds and smells. They require energy to visit, but we believe they can provide big rewards in personal experiences and, with patience, in investment results.



Ferry 'cross the Banani, Dhaka

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